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PRIVATE PENSIONS

401(k) Plan Participants and Sponsors Need Better Information on Fees

Statement of Barbara D. Bovbjerg, Director
Education, Workforce, and Income Security Issues



G A O

Accountability * Integrity * Reliability



Highlights of [GAO-08-95T](#), a testimony before the Senate Special Committee on Aging

Why GAO Did This Study

According to Labor's most recent data, there are an estimated 44 million active participants in 401(k) plans. As participants accrue earnings on their investments, they also pay a number of fees, associated with 401(k) plans. Over the course of the employee's career, fees may significantly decrease retirement account balances. For plan sponsors, understanding the fees they are being charged helps fulfill their fiduciary responsibility to act in the best interest of plan participants.

GAO's prior work on 401(k) fees found that fee disclosures are limited and do not allow an easy comparison of investment options. GAO previously made recommendations to both Congress and Labor on ways to improve the disclosure of fee information to both plan participants and sponsors. Both Labor and Congress now have efforts under way to ensure that both participants and sponsors receive the necessary fee information to make informed decisions. These efforts on the subject have generated significant debate. This testimony provides information about the way fee information could be disclosed to benefit 401(k) participants and sponsors, focusing on 1) the information on fees that could be most useful for plan participants and plan sponsors and 2) how such information could be effectively presented. To complete this statement, GAO relied on previous work and also utilized information from Labor and from industry experts on the subject of fee disclosure to participants.

To view the full product, including the scope and methodology, click on [GAO-08-95T](#). For more information, contact Barbara D. Bovbjerg at (202) 512-7215 or bovbjergb@gao.gov.

PRIVATE PENSIONS

401(k) Plan Participants and Sponsors Need Better Information on Fees

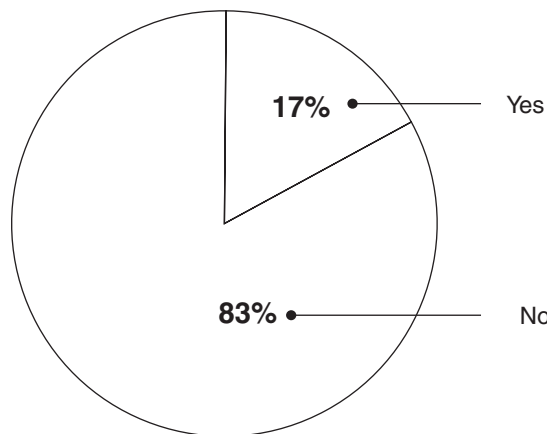
What GAO Found

Fee disclosure serves different functions for plan participants and sponsors. Studies have shown that 401(k) participants often lack basic knowledge about the fees associated with their plan. Participants need information about the direct expenses that could be charged to their accounts. As we previously recommended and most experts agree, the expense ratio—a fund's operating fees as a percentage of its assets—is a fundamental piece of information for participants. Plan sponsors, in contrast, need a range of fee information to fulfill their fiduciary responsibilities. Sponsors need additional information on service providers, investment options, and revenue sharing arrangements to assist them in monitoring plan fees and determining whether they continue to be reasonable in light of the services provided. Labor has ongoing efforts designed to help participants and plan sponsors understand the importance of plan fees and the effect of those fees on retirement savings.

Whether participants receive only basic expense ratio information or more detailed information on fees, presenting the information in a clear, easily comparable format can help participants understand the content of the disclosure. GAO's prior reports found that certain practices help people understand complicated information. For example, using clear language and a straightforward layout in a brief document can enhance the accessibility of financial information. Also, providing graphics and less text can both attract recipient attention and make detailed information more quickly and easily understandable.

Participants' Response to Survey Question on Awareness of Fees

Do you know how much in fees and expenses you are paying for your 401(k) plan?



Source: AARP'S Survey of 401(k) Participants' Awareness and Understanding of Fees, July 2007.

Mr. Chairman and Members of the Committee:

I am pleased to be here to discuss how best to disclose fee information to 401(k) participants and plan sponsors. Fees can significantly decrease participants' retirement savings over the course of a career. For 401(k) participants, even a small fee deducted from a worker's assets today could represent a large amount of money years later had it remained in the account to be reinvested. For plan sponsors, understanding the fees being charged helps fulfill their fiduciary responsibility to act in the best interest of plan participants.

Given that fees can have a large impact on an individual's account balance over time, it is important that both participants, as investors, and plan sponsors, typically the employer, receive the fee information necessary to make informed decisions. The Department of Labor (Labor) is currently drafting regulations on the disclosure of fees to participants, and Congress is now considering legislation to improve such disclosure. These efforts have generated debate about the type of fee information participants and sponsors may need, and the amount and format of fee information that should be disclosed. As Congress considers these issues, you asked us to provide information about the way fees could be disclosed to benefit 401(k) participants and sponsors. My remarks today will focus on 1) the information on fees that could be most useful for plan participants and sponsors and 2) how such information can be presented to participants so that it is easily understandable.

To describe the fee information that should be provided to 401(k) plan participants and sponsors, we relied on our previous work that examined the types of fees associated with 401(k) plans and who pays these fees, how information is disclosed to participants, and Labor's oversight of fees. We also used information from Labor and from industry experts on the subject of fee disclosure to participants. To consider how such fee information should be provided to participants, we reviewed our previous work on the understandability of Social Security and other disclosures, and utilized available industry information on the subject. We conducted our review from September 2007 through October 2007 in accordance with generally accepted government auditing standards.

In summary, fee disclosure serves different functions for plan participants and sponsors. Participants need information about the direct expenses that could be charged to their accounts. As we previously recommended and most experts agree, the expense ratio—a fund's operating fees as a percentage of its assets—is a fundamental piece of information for plan

participants. Some experts also recommend that other types of fees be disclosed, such as certain types of annual fees, and fees that are not necessarily investment-specific. Plan sponsors, in contrast, need a range of fee information to fulfill their fiduciary responsibilities. Thus, sponsors need additional information on service providers, investment options, and revenue sharing arrangements to fulfill their duties as fiduciaries. Such information assists them in monitoring plan fees and determining whether the fees charged continue to be reasonable in light of the services provided. Labor is currently considering what fee information should be provided to participants and what format to enable participants to easily compare fees across a plan's various investment options. The agency also has ongoing efforts designed to help participants and sponsors understand the importance of plan fees and the effect of those fees on retirement savings.

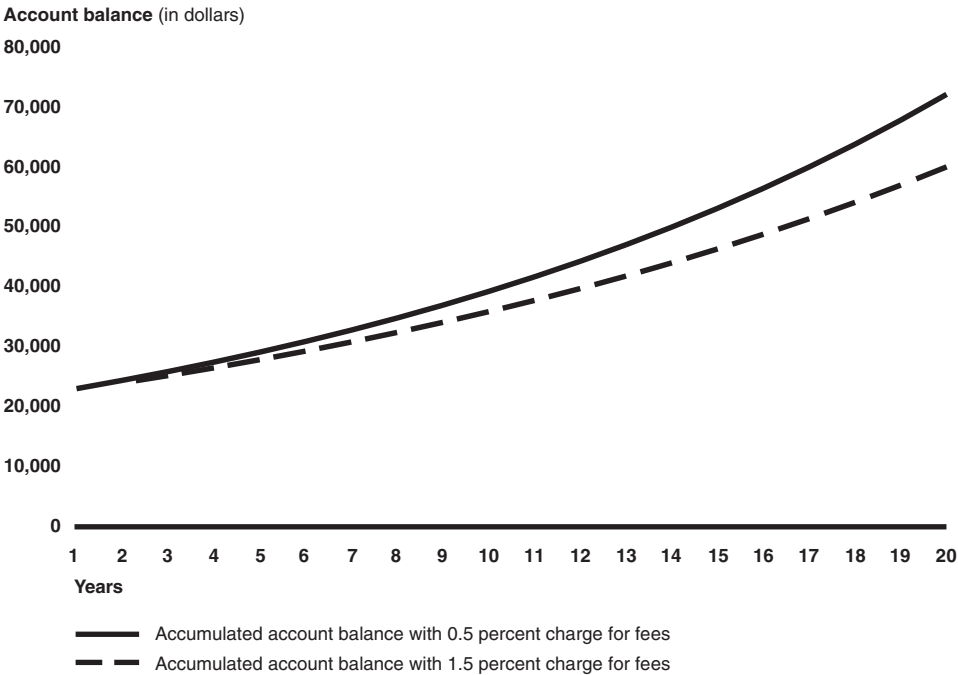
Whether participants receive only basic expense ratio information or more detailed information on various fees, presenting the information in a clear, easily comparable format can help participants understand the content of the disclosure. The language, layout, length, comparability, and distribution are among the important considerations that can inform the design of fee disclosure. In our prior reports on helping the public understand Social Security publications and on more effective disclosures for credit cards, we found that certain practices help people understand complicated information. For example, using clear language and a straightforward layout in a brief document can enhance the accessibility of financial information. Further, providing graphics and less text can both attract recipient attention and make detailed information more quickly and easily understandable.

Background

According to Labor's most recent data, an estimated 41 million participants in 401(k) plans are permitted to direct the investment of all or a portion of their plans' accounts from among the choices offered by their plans. As participants accrue earnings on their investments, they also pay a number of fees, covering expenses, commissions, or other charges associated with 401(k) plans. Over the course of the employee's career, fees may significantly decrease retirement account balances. For example, even a 1-percentage point difference in fees can significantly reduce the amount of money available for retirement. Figure 1 assumes an employee of 45 years of age with 20 years until retirement changes employers and leaves \$20,000 in a 401(k) account until retirement. If the average annual net return is 6.5 percent—a 7 percent investment return minus a 0.5 percent charge for fees—the \$20,000 will grow to about \$70,500 at

retirement. However, if fees are instead 1.5 percent annually, the average net return is reduced to 5.5 percent, and the \$20,000 will grow to only about \$58,400. The additional 1 percent annual charge for fees would reduce the account balance at retirement by about 17 percent.

Figure 1: Effect of 1 Percentage Point in Higher Annual Fees on a \$20,000 401(k) Balance Invested over 20 Years



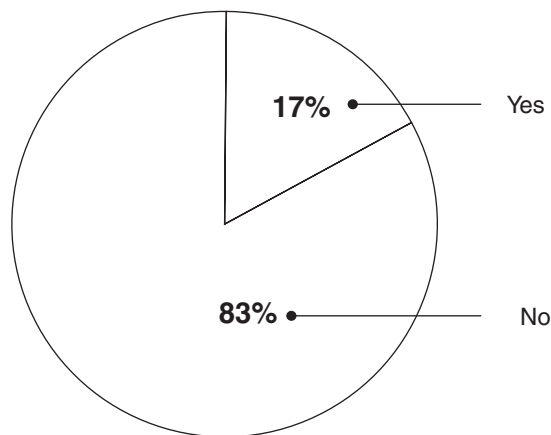
Source: GAO analysis.

Currently, most participants are responsible for directing their investments among the choices offered by their 401(k) plans, but may not be aware of the different fees that they pay. According to industry professionals, participants are often unaware that they pay any fees associated with their 401(k) plan. In fact, studies have shown that 401(k) participants often lack basic knowledge about the fees associated with their plan. As shown in figure 2, in a recent nationwide survey, 83 percent of 401(k) participants reported not knowing how much they pay in fees. When asked whether they pay any fees for the 401(k) plan, less than one-fifth (17%) said they do pay fees. As figure 3 shows, almost two-thirds

responded that they do not pay fees (65%) and 18% stated that they do not know.¹

Figure 2: Participants' Response to Survey Question on Awareness of Fees

Do you know how much in fees and expenses you are paying for your 401(k) plan?

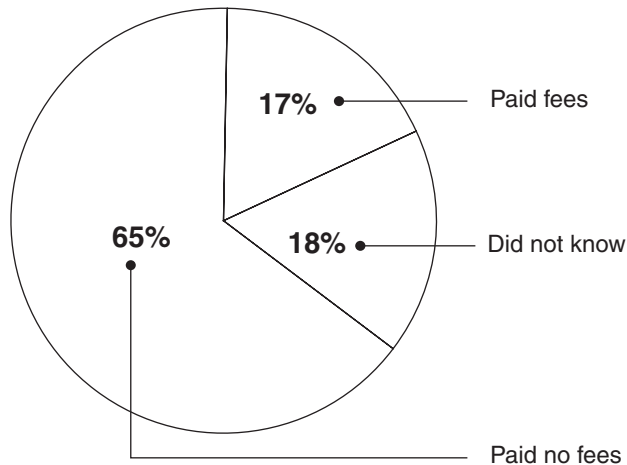


Source: AARP'S Survey of 401(k) Participants' Awareness and Understanding of Fees, July 2007.

¹ AARP Knowledge Management, *401(k) Participants' Awareness and Understanding of Fees*, (Washington, D.C.: July 2007). AARP commissioned a nationally representative survey of 1,584 401(k) plan participants ages 25 and older. The survey was fielded from June 8th through June 24th, 2007 by Knowledge Networks of Menlo Park, California, to members of its nationally representative online panel. The overall sample was designed to be nationally representative of 401(k) plan participants age 25 and older.

Figure 3: Participants' Response to Survey Question on Awareness of Fees

Do you know whether you pay any fees for your 401(k) plan?



Source: AARP'S Survey of 401(k) Participants' Awareness and Understanding of Fees, July 2007.

Industry professionals agree that making participants who direct their investments more aware of fees would help them make more informed investment decisions.

Enacted before these types of plans came into wide use, the Employee Retirement Income Security Act (ERISA) of 1974² establishes the responsibilities of employee benefit plan decision makers and the requirements for disclosing and reporting plan fees. Typically, the plan sponsor is a fiduciary.³ A plan fiduciary includes a person who has discretionary authority or control over plan management or any authority or control over the management or disposition of plan assets.⁴ ERISA requires that plan sponsors responsible for managing employee benefit plans carry out their plan responsibilities prudently and solely in the interest of the plan's participants and beneficiaries. Plan sponsors, as

² 29 U.S.C. §§ 1001-1461.

³ Any person who makes investment decisions with respect to a qualified employee benefit plan's assets is generally a fiduciary. The duties the person performs for the plan rather than their title or office determines whether that person is a plan fiduciary. 29 U.S.C. § 1002(21)(A).

⁴ 29 U.S.C. § 1002(21).

fiduciaries, are required to act on behalf of plan participants and their beneficiaries. These responsibilities include

- selecting and monitoring service providers to the plan;
- reporting plan information to the government and to participants;
- adhering to the plan's investment policy statement and other plan documents (unless inconsistent with ERISA);
- identifying parties-in-interest to the plan and taking steps to monitor transactions with them;
- selecting investment options the plan will offer and diversifying plan investments; and
- ensuring that the services provided to their plan are necessary and that the cost of those services is reasonable.

In our November 2006 report on 401(k) fees, we found that the fee information that ERISA requires 401(k) plan sponsors to disclose is limited and does not provide participants with an easy way to compare investment options.⁵ All 401(k) plans are required to provide disclosures on plan operations, participant accounts, and the plan's financial status. Although they often contain some information on fees, these documents are not required to disclose the fees borne by individual participants. Overall, we found that the information currently provided to participants does not provide a simple way for them to compare plan investment options and their fees, and are provided to participants in a piecemeal fashion.

Additional fee disclosures are required for certain—but not all—plans in which participants direct their investments. ERISA requires disclosure of fee information to participants where plan sponsors seek liability protection from investment losses resulting from participants' investment decisions. Such plans—known as 404(c) plans—are required to provide participants with a broad range of investment alternatives, descriptions of the risks and historical performance of such investment alternatives, and information about any transaction fees and expenses in connection with

⁵ GAO, *Private Pensions: Changes Needed To Provide 401(k) Plan Participants and the Department of Labor Better Information on Fees*, [GAO-07-21](#) (Washington, D.C.: November 16, 2006).

buying or selling interests in such alternatives.⁶ Upon request, 404(c) plans must also provide participants with, among other information, the expense ratio for each investment option. Plan sponsors may voluntarily provide participants with more information on fees than ERISA requires, according to plan practitioners. For example, plan sponsors that do not elect to be 404(c) often distribute prospectuses or fund profiles when employees become eligible for the plan, just as 404(c) sponsors do. Still, absent requirements to do so, some plan sponsors may not identify all the fees participants pay.

Some participants may be able to make comparisons across investment options by piecing together the fees that they pay, but doing so requires an awareness of fees that most participants do not have. Assessing fees across investment options can be difficult for participants because the data are typically not presented in a single document which facilitates comparison. However, most 401(k) investment options have expense ratios that can be compared; according to industry data, the majority of 401(k) assets are in investment options, such as mutual funds that are generally required to present the expense ratio in a prospectus.

Plan sponsors, on the other hand, may currently receive some information on an investment option's expenses that includes management fees, distribution and/or service fees, and certain other fees, such as accounting and legal fees. These fees are usually disclosed in the fund's prospectus or fund profile. In addition to investment fees, sponsors may receive information about fees for administration and other aspects of plan operations. Sponsors can also have providers fill out the Form 5500, which ultimately gets filed with Labor.⁷ Generally, information on 401(k) fees is

⁶ ERISA Section 404(c) generally provides relief for plan fiduciaries of certain individual account plans, such as 401(k) plans, from liability for losses resulting from investment decisions made by plan participants and beneficiaries. 29 U.S.C. § 1104(c). Implementing regulations provide specifics for complying with section 404(c). 29 C.F.R. § 2550.404c-1 (2007).

⁷ The Form 5500 includes information on the plan's sponsor, the features of the plan, and the number of participants. The form also provides more specific information, such as plan assets, liabilities, insurance, and financial transactions. Filing this form satisfies the requirement for the plan administrator to file annual reports concerning, among other things, the financial condition and operation of plans. Labor uses this form as a tool to monitor and enforce plan sponsors' responsibilities under ERISA.

reported on two sections of the Form 5500, Schedule A and Schedule C.⁸ However, our November 2006 report stated that the form is of little use to plan sponsors and others in terms of understanding the cost of a plan.⁹

While plan sponsors may receive information on investment and other fees, they may not be receiving information on certain undisclosed business arrangements. We previously reported that several opportunities exist for business arrangements to go undisclosed, given the various parties involved in creating and administering 401(k) plans. Problems may occur when pension consultants or other companies providing services to a plan also receive compensation from other service providers. Without disclosing these arrangements, service providers may be steering plan sponsors toward investment products or services that may not be in the best interest of participants. In addition, plan sponsors, being unaware, are often unable to report information about these arrangements to Labor on Form 5500 Schedule C. Our November 2006 report recommended that Congress consider amending ERISA to require that service providers disclose to plan sponsors the compensation that providers receive from other service providers.

H.R. 3185, the 401(k) Fair Disclosure for Retirement Security Act of 2007, was introduced in Congress on July 26, 2007, and H.R. 3765, the Defined Contribution Plan Fee Transparency Act of 2007, was introduced on October 4, 2007. The first bill if enacted would, among other things, amend ERISA to require detailed fee disclosures from service providers to plan sponsors, as well as from plans to participants, and establish additional specific requirements related to the selection of investment options by 404(c) plan sponsors. It would also require Labor to take various steps related to the enforcement of these requirements and would create statutory penalties for failure to comply. The second bill would amend the Internal Revenue Code to impose taxes on any defined contribution plan

⁸ Schedule A is used to report fees and commissions paid to brokers and sales agents for selling insurance products. Schedule C includes information on the fees paid directly to service providers for all other investment products, but excludes investment fees deducted from returns. Schedule C also identifies service providers with fees in excess of \$5,000 by name.

⁹ Labor's ERISA Advisory Council Working Group on Plan Fees and Reporting on Form 5500 came to this conclusion, stating that only the fees that are billed explicitly and are paid from plan assets are deemed reportable. Many of the fees are associated with the individual investment options in the 401(k) plan, such as a mutual fund, and are deducted from investment returns and not reported to plan sponsors or on the Form 5500.

administrator failing to provide plan participants with prescribed information about plan fees and expenses, and on any plan service provider failing to provide defined contribution plan administrators prescribed information about plan fees and expenses. Both bills suggest that a satisfactory disclosure to participants would include a statement explaining that investments should not be selected based solely on the level of fees charged but also on careful consideration of a range of factors including the alternatives' risk level, historic returns, and investment objectives.

Basic Fee Information is Important for Participants to make Informed Decisions but Plan Sponsors Require Broader Information

Fee disclosure serves different functions for plan sponsors and participants. Participants need fee information to make informed decisions about their investments—primarily, whether to contribute to the plan (and at what level) and how to allocate their contributions among the investment options the plan sponsor has selected. As we previously recommended and most experts agree, the expense ratio is a fundamental piece of information for plan participants. Plan sponsors, as fiduciaries, must consider a range of information, in addition to information on fees, such as hiring and supervising plan service providers, selecting investment options, and reviewing the reasonableness of plan fees.

Participants Need Fee Information to Make Informed Comparisons and Decisions about How to Direct their Investments

Although it is clear that participants require fee information to make informed decisions, it is not so clear what fee information is most relevant. Better disclosure of fee information is important because participants in 401(k) plans generally receive less information and guidance from investment professionals regarding their investment decisions than direct investors. According to industry experts, participants need to be given information about the direct expenses that could be charged to their accounts.

In our 2006 report on fees, we found that fees are charged by the various outside companies that the plan sponsor hires to provide a number of services necessary to operate a plan. Services can include

- investment management (i.e., selecting and managing the securities included in a mutual fund; marketing the fund and compensating

brokers who sell the fund;¹⁰ and providing other shareholder services, such as distributing the fund prospectus);¹¹

- recordkeeping (i.e., tracking individual account contributions);
- consulting and providing financial advice (i.e., selecting vendors for investment options or other services);
- custodial or trustee services for plan assets (i.e. holding the plan assets in a bank); and
- telephone or Web-based customer services for participants.

In our report, we recommended that Congress consider amending ERISA to require all sponsors of participant-directed plans to disclose fee information on 401(k) investment options to participants in a way that facilitates comparison among the options, such as via expense ratios.¹² As mentioned earlier, there have been two bills recently introduced in Congress on the subject. Industry professionals have also suggested that comparing the expense ratio across investment options is the most effective way to compare options' fees. They generally agree that an expense ratio provides valuable information that participants need and can be used to compare investment options because it includes investment fees, which constitute most of the total fees borne by participants. According to an industry official, the disclosure of expense ratios might include a general description of how expense ratios vary depending on the type and style of investment. For example, investment options with relatively high fees, such as actively managed funds, tend to have larger expense ratios than funds that are not actively managed. Also, investment options that are only available to institutional investors tend to have lower expense ratios than other types of funds.

Most of the investment options offered in 401(k) plans have expense ratios that can be compared, but this information is not always provided to participants. In addition, investment options other than mutual funds may

¹⁰ Fees related to marketing and compensating brokers to sell the fund are known as 12b-1, or distribution fees, and are limited by the Financial Industry Regulatory Authority, the entity that succeeded the National Association of Securities Dealers Inc., to a maximum of 1-percentage point of the total expense ratio per year.

¹¹ Investment fees are usually different for each investment option available to participants in a 401(k) plan, account for the bulk of plan fees, and are paid by participants.

¹² We found that it is hard for participants to make comparisons across investment options because they have to piece together the fees that they pay, and assessing fees across investment options can be difficult because data are not typically presented in a single document that facilitates comparison.

not be required to produce prospectuses that include expense ratios, but according to industry professionals, such options have expense ratio equivalents that investment industry professionals can identify. Despite the general consensus that the expense ratio is the most fundamental piece of information that participants receive on fees, industry officials also believe that other fees should be disclosed to participants. For example, annual fees or fees on a per-transaction basis could be disclosed, such as administrative and recordkeeping fees, participant loan origination fees, and annual loan charges.¹³

In addition, industry professionals also recommended that additional investment-specific fees be disclosed, including

- redemption fees or sales charges—fees that may be imposed by the provider as a result of changing investments in a given period;
- surrender charges—fees that may be imposed as a result of selling or withdrawing money from the investment within a given number of years after investing; and
- wrap fees—fees that are assessed on the total assets in a participant’s account.¹⁴

Industry experts said that it was important that participants receive information about their investment returns. For example, some officials recommended that plan participants be provided information on their returns net of all fees so that they can clearly see what their investments have earned after fees. Others recommended that information be disclosed that explains how the investment and administrative costs of the plan affect their investment returns and their overall retirement savings in the plan. These officials believed that such information would help participants understand that fees are an important factor, but not the only one, to consider when directing their investments. In fact, most experts

¹³ Plan record-keeping fees cover individual account maintenance for plan participants. They cover a variety of activities, such as enrolling participants, processing fund selections, preparing and mailing account statements, and other related administration activities. A loan origination fee is charged to a participant who elects to take a loan from the plan. The fee covers document preparation and loan processing expenses. Annual loan charges are imposed for account maintenance.

¹⁴ Wrap fees are for various expenses, such as sales commissions, administrative expenses, and/or recordkeeping fees. However, wrap fees can also be assessed against specific investment options and/or at the plan level based on total plan assets. For example, a wrap fee may be assessed against a “low fee” investment option because the investment provider does not contribute toward the cost of plan recordkeeping and administration.

agree that risk and historical performance are important factors for participants to also consider when making investment decisions.

Although some industry experts believe that participants should be provided comparative benchmarks for their investment options, not all experts agreed.¹⁵ Most industry experts we consulted believed that benchmarks would be more useful for plan sponsors. Since plan participants do not have any control over the investment options offered in a plan, experts said that benchmarking is less useful to plan participants than plan sponsors, since plan sponsors use benchmarks in evaluating alternatives to their plans' investment options. Experts also noted that although there are appropriate benchmarks for mutual funds, benchmarks are not as readily available for other types of investment products.

Industry experts agreed that overall there is certain minimum information that participants should receive for each investment option offered under all self-directed plans, such as 1) the types of securities held and investment objectives of the product; 2) the principal risks associated with investing in the product; 3) annual fees and expenses expressed in a ratio or fee table; 4) information on historical performance; and 5) the identity of the investment manager of the plan's investments. Disclosure of this information is appropriate for all types of investment options available under the plan regardless of type and can fill in the gaps in the information currently required to be provided to participants. For example, with the exception of mutual funds, for most other types of investment products, important information—such as operating expenses and historical performance—is available only on request. Industry experts support requiring the provision of a summary document for all self-directed plans that provides, for each investment product, the type of information that investors value and use.

Labor's initiatives related to
401(k) plan participants

In our prior work, we noted that Labor is considering the development of a new rule regarding the fee information required to be furnished to participants under its section 404(c) regulation. According to Labor officials, they are attempting to identify the critical information on fees that plan sponsors should disclose to participants and the best way to do so. The initiative is intended to explore what steps might be taken to

¹⁵ A benchmark is used to compare specific investment results with that of the market or economy. Some industry experts believe that plan sponsors, as they monitor investment alternatives, should review investment-alternative results against appropriate benchmarks and compare their plans' investment options to competing funds with similar styles.

ensure that participants have the information they need about their plan and available investment options, without imposing additional costs, given that such costs are likely to be charged against the individual accounts of participants and affect their retirement savings. The officials are currently considering what fee information should be provided to participants and what format would enable participants to easily compare the fees across a plan's various investment options. Labor is also currently evaluating comments received from consumer groups, plan sponsors, service providers, and others as it develops its proposed regulation.

Labor also has ongoing efforts designed to help participants and plan sponsors understand the importance of plan fees and the effect of those fees on retirement savings. Labor has developed and makes available on its Web site, a variety of educational materials specifically designed to help plan participants understand the complexities of the various fee and compensation arrangements involved in 401(k) plans. Its brochure titled *A Look at 401(k) Plan Fees* is targeted to participants and beneficiaries of 401(k) plans who are responsible for directing their own investments.

Broader Information Can Help Plan Sponsors Fulfill Their Fiduciary Responsibilities

Although participants' fee requirements are more specific to the investment options offered to them by the plan sponsor, a broader spectrum of information relating to fees is needed by plan sponsors. In order to carry out their duties, plan sponsors have an obligation under ERISA to prudently select and monitor plan investments, investment options made available to the plan's participants and beneficiaries, and the persons providing services to the plan. Understanding and evaluating the fees and expenses associated with a plan's investments and services are an important part of a fiduciary's responsibility. Plan sponsors continually need, in addition to information on fees, information on service providers, investment options, and revenue sharing arrangements in order to monitor a plan's fees and expenses to determine whether they continue to be reasonable for the services provided.

Industry experts have suggested that plan sponsors be required to obtain complete information about investment options before adding them to the plan's menu and obtain information concerning arrangements where a service provider receives some share of its revenue from a third party. A number of associations recently put together a list of service- and fee-related data elements they believe defined contribution plan sponsors and service providers should discuss when entering into agreements. The data elements include such information as payments received by plan service providers from affiliates in connection with services to the plan, float

revenue,¹⁶ and investment-related consulting services. The list is meant as a reference tool for plan sponsors and providers to use to determine the extent to which a service provider receives compensation in connection with its services to the plan from other service providers or plan investment products (e.g., “revenue sharing” or “finders’ fees”). According to the associations that formulated this tool, the information can aid plan sponsors to evaluate any potential conflicts of interest that may arise in how fees are allocated among service providers.

Labor, in its comments to our November 2006 report, stated that the agency has proposed a number of changes to the Form 5500, including changes that would expand the information required to be reported on the Schedule C. The changes are intended to assist plan sponsors in assessing the reasonableness of compensation paid for services and potential conflicts of interest that might affect those services. According to testimony earlier this month from the Assistant Secretary of Labor, the agency will be issuing a final regulation requiring additional public disclosure of fee and expense information on the Form 5500 within the next few weeks.¹⁷ This change will be helpful to plan sponsors as they look retrospectively at the preceding plan year. In addition, Labor was considering an amendment to its regulation under section 408(b)(2) of ERISA, expected to be issued this year. This amendment would help to ensure that plan sponsors have sufficient information on the compensation to be paid to the service provider and the revenue sharing compensation paid by the plan for the specific services and potential conflicts of interest that may exist on the part of the service provider.

Labor’s ERISA Advisory Council currently has a working group focusing on fiduciary responsibility and revenue sharing. One area of focus is what service providers should be required to provide when they enter into a revenue sharing or rebate arrangement. Labor also provides a model form on its Web site specifically designed to assist plan fiduciaries and service providers in exchanging complete disclosures concerning the costs involved in service arrangements. Other associations and entities continue to develop model fee-disclosure forms for plan sponsors.

¹⁶ Float revenue is revenue earned from the short-term investment of plan assets.

¹⁷ Statement of Bradford P. Campbell, Assistant Secretary of Labor, Before the Committee on Education and Labor, U.S. House of Representatives, Oct. 4, 2007.

We are currently conducting work in the area of 401(k) plan sponsor practices, identifying how plan sponsors decide which features to include in the plans they establish and how plan sponsors oversee plan operations. Part of our work will consider how plan sponsors monitor the fees charged to their plans. We expect to issue a report in 2008.

Making Fee Information Easy to Understand and Compare Can Help 401(k) Participants with Disclosed Information

Whether participants are provided with basic expense ratio information or more detailed information on various fees, or both, providing the information in a clear, easily comparable format can assist participants in understanding the information disclosed. In our prior reports on helping the public understand Social Security information and on more effective disclosures for credit cards, we found that certain practices help people understand complicated information.¹⁸ These practices include

- language—writing information in clear language;
- lay-out—using straightforward layout and graphics;
- length—providing a short document;
- comparability—making options easy to compare in a single document; and
- distribution—offering a choice of paper or electronic distribution.

Language: We previously noted that certain disclosure materials for the public should be written at or below an eighth-grade reading level given the diverse population receiving it. Unclear or highly technical language can affect the understandability of disclosures to participants. Plain English can reduce confusion and promote comprehension. Currently, according to one industry expert, prospectuses do not provide an understandable summary of investments or their expenses to participants since prospectuses are largely written to protect the fund. As disclosures address fees beyond the expense ratio, clear language remains important so that participants understand what key fees mean and when they apply.

¹⁸ GAO, *Social Security Statements: Social Security Administration Should Better Evaluate Whether Workers Understand Their Statements*, [GAO-05-192](#) (Washington, D.C.: Apr. 1, 2005); GAO, *Social Security Administration: Longstanding Problems in SSA's Letters to the Public Need to Be Fixed*, [GAO/HEHS-00-179](#) (Washington, D.C.: Sept. 26, 2000); GAO, *Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers*, [GAO-06-929](#) (Washington, D.C.: Sept. 12, 2006); and GAO, *SSA Benefit Statements: Well Received by the Public but Difficult to Comprehend*, [GAO/HEHS-97-19](#) (Washington, D.C.: Dec., 5, 1996).

Layout: Some consumer and industry groups emphasized the need for a straightforward layout. In response to Labor’s Request For Information on fee disclosure to participants,¹⁹ one industry group stated that disclosure with a simple format may lead some participants to consider fees as one of many factors in their investment decisions. The group added that complex language or layout hinders meaningful disclosure. Similarly, in our previous work on Social Security disclosures, we noted that the design of certain disclosures did not clearly identify the most important information or easily lead the reader through the document. For example, letters and statements to beneficiaries were harder to follow when the order of information did not flow logically or the most important information did not appear first in the document. Another aspect of layout—the use of inappropriate font sizes and styles—can make a disclosure more difficult for consumers to read, as we found in our prior work on credit card fee disclosures. For example, materials that excessively use capital letters or a small font may be more difficult to read.

Our prior work also revealed that using graphics helps people understand complicated information or information that needs to be compared. Table 1 shows an example of how industry associations suggest that the expense ratio and other fee information could be disclosed to plan participants. Using a table can be a particularly effective way to convey information. In a previous report, we noted that using graphics to replace text and make some information more quickly and easily understandable was a common theme that emerged in the suggestions made by focus groups and a benefits consulting firm.

¹⁹ 72 Fed. Reg. 20,457 (Apr. 25, 2007).

Table 1: Sample Participant Fee Disclosure Form

Investment expenses			
Investment option	Participant's assets	Expense ratio (as a percentage)	Additional fees
AAA investment	\$5,000	0.30%	0.00%
BBB investment	\$6,000	0.22%	0.00%
CCC investment	\$12,000	0.36%	2.00%
DDD investment	\$0	0.43%	1.50%
EEE investment	\$0	0.27%	0.00%
FFF investment	\$42,000	0.18%	0.00%
GGG investment	\$3,000	0.60%	1.00%
Administrative and transactional expenses			
Service			Amount of fee
Annual administrative and recordkeeping charge			\$50 per year
Brokerage account			\$60 per year
Participant loan origination fee			\$50 per loan
Annual loan charge			\$25 per year

Source: Industry associations, including the American Society of Pension Professionals & Actuaries and the Council of Independent 401(k) Recordkeepers.

Length: In addition to clear language and layout, the length of the document can influence how useful it is for participants. Some groups have concerns that too much information can overwhelm participants. For participant-directed plans, a few studies have shown that more investment options are correlated with reduced participation or other outcomes, possibly because of too many choices or information overload. Shorter disclosures are emerging for a number of vehicles for retirement savings. For example, the Securities and Exchange Commission (SEC) is currently considering rules to develop a streamlined prospectus. This affects the presentation of information about mutual funds, which constitute over half of 401(k) assets according to industry data. Omitting unnecessary details from disclosure documents makes recipients more likely to read and understand information they contain.

Clear, short annual disclosures do not preclude making additional information available, especially when using an electronic format. With 401(k) plans, the availability of additional material permits participants to review greater detail about fees and other fund characteristics through documents like a prospectus or fund profile. These additional sources can be paper or electronic, and industry groups noted that an electronic

format can allow layered disclosure with initial summary information and links to further material or source documents. In addition, providing ways for participants to obtain more detailed information is helpful. For example, experts we consulted during our work on the Social Security Statements²⁰ advised that statements should contain directions on how to obtain additional information.

Comparability: Our November 2006 report on 401(k) fees emphasized the importance of a single document that facilitates the comparison of fund options. In their responses to Labor's Request for Information, industry groups recently reiterated the importance of disclosures that promote comparisons, which would assist participants and treat providers of different types of investments evenly. As we recommended to Congress, disclosure in a single document that includes expense ratios should occur in a way that promotes easy comparison. Similarly, additional fees like redemption fees or surrender charges that may relate to certain investment options can also be compared in one document enabling participants to know what fees they may incur for activities like buying and selling in certain funds. Disclosures in multiple documents may be more difficult for the reader to use because they may require more work to find information, especially when delivered over time.

Distribution: Possible ways to deliver 401(k) fee disclosure include both paper and electronic distribution. Paper reports, such as summary plan descriptions, prospectuses for mutual funds, and other documents, traditionally have been used to provide pension and fee information. Not all participants have computer or internet access, and many may prefer paper disclosure, as indicated by a recent nationwide survey about 401(k) fee disclosure. Although paper disclosure rather than electronic delivery may suit certain participants, many industry groups place emphasis on computer-based formats, partly to lower costs like printing and mailing and to allow layered disclosure by clicking to more detailed information or source documents. One industry association commented that Internet-based information is easier to maintain and update so that it tends to be more timely and accurate.

Recent pension legislation has discussed electronic disclosure in some circumstances. The Pension Protection Act of 2006 allows paper, electronic, or other formats for benefit statements to the extent that the

²⁰ [GAO-05-192](#).

format is reasonably accessible to the participant or beneficiary.²¹ In guidance about benefit statements issued in 2006, Labor stated that continuous access to one or more secured Web sites is one way of providing information as long as, among other things, notification about the sites includes the right to request and obtain free paper versions. In addition, Labor has issued a regulation for the general use of electronic disclosure to participants and beneficiaries.²² Also, SEC has recently adopted and proposed rules with increased electronic disclosure, partly to reduce costs, which allow for paper disclosure as well as electronic delivery.²³

Conclusions

It is apparent that both 401(k) plan participants and sponsors need fee information in order to make the most informed decisions. However, given the voluminous amount of information that could be disclosed to participants, determining the relevant information that participants most need is key. At a minimum, providing information such as expense ratios or other investment-specific fee information could be the place to start. Also, making sure that the information is accessible in terms of the language, layout, length, comparability, and distribution can ensure that participants actively utilize the information disclosed. As participants become more sophisticated or demand more information, decisions can then be made about the type and format of additional fee information.

For plan sponsors, requiring that certain information on fees be disclosed can help them understand what services they are paying for, who is benefiting, and whether their current arrangements are in the best interest of plan participants. The mere act of requiring such information may actually promote competition among the entities that provide services to plans and possibly reduce the amount of fees service providers charge.

Mr. Chairman, this concludes my prepared statement. I would be happy to respond to any questions you or other Members of the Committee may have at this time.

²¹ Pub. L. No. 109-280, § 508(a), 120 Stat. 780, 949-51 (codified at 29 U.S.C. § 1025).

²² 29 C.F.R. § 2520.104b-1(c) (2007).

²³ 72 Fed. Reg. 42,222 (Aug. 1, 2007).

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